

**STATE BOARD OF ACCOUNTS**  
**302 West Washington Street**  
**Room E418**  
**INDIANAPOLIS, INDIANA 46204-2769**

REVIEW REPORT  
OF  
INDIANA DEPARTMENT OF INSURANCE  
STATE OF INDIANA  
June 1, 2004 to July 31, 2006



**FILED**  
02/27/2007



## TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Agency Officials.....	2
Independent Accountant's Report .....	3
Review Comments:	
SDO Advance.....	4
Contract Forms and Approvals.....	4
Collection of Examination Fees.....	5
Reimbursement of Examiner Travel Expenses – State Employees.....	6
Lack of Subsidiary Ledgers .....	6
Verification of Claims – Mine Subsidence Fund.....	7
Bail and Recovery Agent Examination Fees .....	7
Exit Conference .....	8
Official Response .....	9-11

#### AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Commissioner	Sally B. McCarty Amy Strati (Interim) Jim Atterholt	01-08-01 to 07-14-04 07-15-04 to 01-09-05 01-10-05 to 01-11-09



# STATE OF INDIANA

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## INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF THE INDIANA DEPARTMENT OF INSURANCE

We have reviewed the receipts, disbursements, and assets of the Indiana Department of Insurance for the period of June 1, 2004, to July 31, 2006. The Indiana Department of Insurance's management is responsible for the receipts, disbursements, and assets.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the receipts, disbursements, and assets. Accordingly, we do not express such an opinion.

Financial transactions of this office are included in the scope of our audits of the State of Indiana as reflected in the Indiana Comprehensive Annual Financial Reports.

Based on our review, nothing came to our attention that caused us to believe that the receipts, disbursements, and assets of the Indiana Department of Insurance are not in all material respects in conformity with the criteria set forth in the Accounting and Uniform Compliance Guidelines Manual for State Agencies, and applicable laws and regulations except as stated in the review comments.

STATE BOARD OF ACCOUNTS

December 27, 2006

INDIANA DEPARTMENT OF INSURANCE  
REVIEW COMMENTS  
JULY 31, 2006

SDO ADVANCE

As stated in our prior Reports B24471 and B16740, the Special Disbursing Officer Fund (SDO) advance of \$1,000 for the Department of Insurance had not been turned over, or reimbursed completely, for several months. During the current review period the SDO advance was not turned over for several months.

If a SDO advance is not used within one or two months then the SDO advance is too large and should be reduced. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 7)

CONTRACT FORMS AND APPROVALS

As stated in our prior Report B24471, the Indiana Department of Insurance (IDOI) enters into professional service contracts without the review or approval by the Department of Administration, the State Budget Agency, or the Attorney General's office. Many of these contracts consist of letters of agreement which lack substantial portions of required State contract language.

Certain types of contracts are entered into routinely by IDOI using standard forms which have not been approved by the Attorney General's office. The IDOI has indicated that its public function would be severely restricted if each such contract was subjected to the standard approval process; however, it has not filed written delegations of authority to approve such contracts with the Department of Administration. These types of contracts include:

1. Appointment agreements to designate the special deputy liquidator for insolvency estates.
2. Reinsurance agreements for insurance companies who participate in the Mine Subsidence Fund.
3. Insurance policies issued by the Political Subdivision Risk Management Fund.
4. Joint custodial agreements for custodial deposits maintained at banks by insurance companies on behalf of policy holders.
5. Claim settlements for the Patient's Compensation Fund, Mine Subsidence Fund and Political Subdivision Risk Management Fund.
6. Consultant contracts for examinations of insurers.

Indiana Code 4-13-2-14.3 states that: "... the attorney general must review for form and legality contracts to which a state agency is a party." Indiana Code 4-13-2-14.1 and 14.2 require that a contract to which a state agency is a party must be properly approved by the Department of Administration, the Budget Agency, and the Attorney General's office. Indiana Code 4-13-2-14.1(b) states that the Department of Administration, the Budget Agency and/or the Attorney General's office may delegate responsibility to approve contracts but that "The delegation must be in writing and must be filed with the Indiana department of administration."

INDIANA DEPARTMENT OF INSURANCE  
REVIEW COMMENTS  
JULY 31, 2006  
(Continued)

COLLECTION OF EXAMINATION FEES

As stated in our prior reports (most recently B24471 and B16740), every insurance company that conducts business within the State of Indiana is subject to an examination at least once every three to five years. According to Indiana Code 27-1-3.1-9, the Commissioner of the Indiana Department of Insurance (IDOI) is empowered to "... retain attorneys, appraisers, independent CPAs or other professionals and specialists as examiners. The cost of retaining these examiners shall be borne by the company that is the subject of the examination." The insurance companies pay the cost of the IDOI examiner's salary plus a 75% loading for fringe benefits and administrative expenses. The examiner's mileage, per diem and the cost of any professionals consulted in connection with the examination are billed directly to the company by the examiner. The examined insurance company may receive as many as four or more invoices for an examination, requiring them to make as many payments.

The existing procedure consists of state employees issuing invoices to, and receiving payments from, the examined insurance companies directly for their travel expenses. Any retained professionals, such as CPA firms or actuaries, invoice IDOI. Invoices are then stamped "approved" and forwarded to the examined insurance company who makes payment directly to the retained firm. To ensure proper internal controls and accountability over public funds, current policy and procedures would dictate that all payments for examinations from the examined companies would be sent to the IDOI, deposited into state accounts, and then IDOI would pay employees or retained professionals. The current account structure of the IDOI is not conducive to these control procedures.

Each agency is responsible for compliance with applicable statutes, regulations, contract provisions, and state policies. Compliance is required, as applicable, with generally accepted accounting principles, and standards issued by the Governing Accounting Standards Board, Financial Accounting Standards Board, and other standard setting bodies and also with various accounting guides, manuals, and other publications. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

IDOI's official response to this prior finding stated that the examination fees, as statute mandates, are to be borne by the company being examined. The travel expenses are agreed upon by the company and the department prior to the examination. For the department to insert itself between the company and the examiner for the purpose of processing these payments would add an unnecessary bureaucratic layer to a procedure that has functioned successfully.

Upon review of IDOI's official response to our prior reports, in 2001 we requested an Attorney General's opinion regarding direct billings by outside consultants.

In an opinion issued to the State Board of Account's State Examiner on January 16, 2002, and subsequently forwarded to the Commissioner of the Department of Insurance, the Office of the Attorney General stated: "Although it may be expedient to have the company pay individuals directly, the statute does not contemplate such a process." The Attorney General also indicated that, because outside consultants function as agents of the Department, "... consultants retained by the department should be compensated by the department even though it is the ultimate responsibility of the companies that are being examined to reimburse the department for those costs."

INDIANA DEPARTMENT OF INSURANCE  
REVIEW COMMENTS  
JULY 31, 2006  
(Continued)

REIMBURSEMENT OF EXAMINER TRAVEL EXPENSES - STATE EMPLOYEES

As stated in our prior Report B24471 and as noted in our finding entitled "Collection of Examination Fees," the Indiana Department of Insurance allows examiners to directly bill insurance companies for reimbursement of their travel costs. Insurance companies forward copies of examiner expense reports to the Department upon payment.

In their official response to our prior report, the IDOI agreed to but did not create a formal policy regarding examiner billing during the review period.

In an opinion issued to the Indiana State Board of Account's State Examiner on January 16, 2002, and subsequently forwarded to the Commissioner of the Department of Insurance, the Office of the Attorney General stated: "... although it may be expedient to have the company pay individuals directly, the statute does not contemplate such a process."

Financial Management Circular 2003-1, Section 2-6 states: "An Agency may develop internal policies and procedures relating to State Travel by State Travelers. Such policies and procedures may not be inconsistent with this Circular and must be approved by both the State Budget Director and the Commissioner [of the Indiana Department of Administration], or their respective designees." Section 3-2 states: "Out-of-State Travel must be approved in advance in writing by the Commissioner, and the Agency Head, or their designees. . . . In-State Travel must be approved in advance by the Agency." Section 4-7 states: "The rates of reimbursement for Travel Allowances shall be those established, in accordance with law, by the State Budget Director and adopted by the Commissioner." 40 IAC 2-1-9(3)(b) states: "A state officer or employee shall not solicit or accept compensation other than that provided for by law for such state officer or employee for the performance of official duties."

LACK OF SUBSIDIARY LEDGERS

As stated in our prior Report B24471, we observed that the Indiana Department of Insurance (IDOI) did not have an effective subsidiary ledger for the Mine Subsidence Fund.

IDOI acts as a reinsurer for mine subsidence policies issued in certain former coal mining communities. IDOI receives a percentage of all premiums collected in exchange for the promise to honor individual claims. However, IDOI does not collect any detailed information from insurers regarding policies issued and effective dates that would allow it to maintain a subsidiary ledger to verify individual claims against prior premium payments.

Each agency has the following accounting responsibilities to maintain an effective and accurate system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger and reconciled bank or Auditor's balance should agree. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)



INDIANA DEPARTMENT OF INSURANCE  
REVIEW COMMENTS  
JULY 31, 2006  
(Continued)

VERIFICATION OF CLAIMS - MINE SUBSIDENCE FUND

As stated in our prior Report B24471, the practice of obtaining an independent engineer's opinion to verify claims against the Mine Subsidence Fund was discontinued. Instead, the Indiana Department of Insurance (IDOI) allowed insurance companies submitting claims for reimbursement to obtain the required engineer's opinion. As noted in our finding entitled "Lack of Subsidiary Ledgers," during this same time period the IDOI did not independently maintain detailed records regarding policies issued. As a result, IDOI relied on insurance companies not only to attest that a covered incident had occurred, but that the underlying policy had been issued and paid for.

Each agency should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records. Examples of control procedures include: proper authorization of transactions and activities; adequate separation of duties; independent checks on performance; adequate documents and records; and adequate safeguards over access and use of assets and records. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

BAIL AND RECOVERY AGENT EXAMINATION FEES

As stated in our prior Report B24471, and during the current review period, the Indiana Department of Insurance (IDOI) did not charge the full statutory rate of \$100 for bail bond and recovery agent examination fees. Instead, IDOI negotiated a lower rate of \$68 with an independent testing vendor. Under the terms of the contract with the vendor, the vendor collected examination fees at the negotiated rate directly from applicants as its full compensation under the contract. The difference between the negotiated and statutory rate was not collected from applicants and remitted to IDOI by the vendor, nor was it collected directly by IDOI.

Indiana Code 27-10-3-4 states: ". . . an examination fee of one hundred dollars (\$100) must be submitted to the commissioner with each application for the issuance of a bail agent's license." Indiana Code 27-10-3-5 states: ". . . for a license to serve as a recovery agent . . . an examination fee of \$100 shall be submitted."

INDIANA DEPARTMENT OF INSURANCE  
EXIT CONFERENCE

The contents of this report were discussed on February 1, 2007, with Jim Atterholt, Commissioner; and Amy Strati, former Interim Commissioner. The official response has been made a part of this report and may be found on pages 9 through 11.



# STATE OF INDIANA

MITCHELL E. DANIELS, JR., Governor

# IDOI

## INDIANA DEPARTMENT OF INSURANCE

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JAMES ATTERHOLT, Commissioner

February 21, 2007

Indiana State Board of Accounts  
302 West Washington Street, Room E418  
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To Whom It May Concern:

This letter contains the Indiana Department of Insurance's Official Response to the State Board of Accounts Audit Results and Comments as presented to the Indiana Department of Insurance.

### CONTRACT FORMS AND APPROVALS

The process of preparing and monitoring contracts was moved to the Legal Division approximately six months ago. Issues identified in the January 6, 2005, report were not addressed before then. Since that time, the contract attorney has been working on addressing the concerns in the previous audit report. We expect to have a contract in place with the special deputy liquidator for insolvency estates -- approved by the attorney general's office -- by July 1, 2007. Other contracts will follow.

The Indiana Political Subdivision Risk Management Commission is a separate body, corporate and politic, "constituting an instrumentality of the state for the public purposes set out in this chapter, but not a state agency" (see IC 27-1-29-5). As such, the Department believes the provisions of IC 4-13-2-14.1 ("Except as provided in subsection (e), the attorney general must review for form and legality contracts to which a state agency is a party . . .") do not apply to the Commission. Furthermore, the Commission is not controlled by the IDOI. Rather, the commissioner of the IDOI is the chair of a board consisting of 11 members.

### COLLECTION OF EXAMINATION FEES

IC 27-1-3.1-9(d) states "when making an examination under this chapter, the commissioner may retain attorneys appraisers, independent actuaries, independent certified accountants, or other professionals and specialist as examiners. The cost of retaining these examiners shall be borne by the company that is the subject of the examination." (emphasis added). The Department is not violating the statute by its current practice. The Department acknowledges that the Attorney General has expressed

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an opinion on a preferred practice. However, if the procedure were to change and the Department be responsible for paying consultants and receiving reimbursement from the insurance company the result would be extremely significant to the Department. The issue is more complex than the Department being asked to collect payments from insurance companies and in turn forward to the examiners. Under the suggested interpretation of the IC 27-1-3.1 the Department would be responsible for payment of the examiners expenses. In the event of a slow payment or default on payment by the insurer the suggested interpretation would result in the Department being financially liable for payment and then the Department would need to seek repayment by the examined entity. Such circumstances could bring a significant lag in payment to the Department for the funds it was required to front to the examiner. A circumstance of slow payment is not unusual, especially with financially troubled companies. Under our current budget the Department is unable to make payments to the examiner until receiving payment from the company. Our budget would need to be increased at a minimum to allow for the possibility of default or delays. As the Department has asserted several times we disagree with this interpretation. Under the Department's interpretation the Department does not believe that it is responsible to the examiner if the insurer fails to pay. The examiner's remedy would be with the company rather than the Department. The Department takes steps to ensure the examiner is aware of this fact and the examiner, in the engagement letter, acknowledges that the Department is not responsible for payment of the expenses. In addition, it is important to note that all examination expenses are reviewed by the Department and approved before being sent to the Company for payment.

Currently outside examiners conduct 95% of the Department's financial and market conduct examinations. We believe that the Department's ability to perform examinations would be severely undercut by the recommended change. The potential consequences are significant, including but not limited to the loss of accreditation with the National Association of Insurance Commissioners. The costs of these examinations and other reviews of financial transactions far exceed the Department's current budget. In light of the State's current financial situation, the Department will not make a change to procedures that are working efficiently and do not clearly violate the statute when the change would have a serious impact on the State's general fund.

However, the Department acknowledges that this issue has been raised in the past and needs to be resolved. The Department will review changes to its procedures that will address these issues without exposing the Department to liability to the examiner for expenses that are clearly intended to be paid by the company and not paid, in whole or part, by the State of Indiana. In addition, the Department is reviewing legislation to amend the statute, during the short session in 2008, to clearly state acceptable procedures.

#### REIMBURSEMENT OF EXAMINER TRAVEL EXPENSES – STATE EMPLOYEES

The Department acknowledges the need for improved procedures and clearer guidance regarding travel expenses for examiners who are state employees. The Department had adopted an informal policy, but will develop and implement a formal policy on this issue.

Pursuant to IC 27-1-3.1-9 examinations are governed by the NAIC examiners handbook which includes provision on travel expenses. The Department will not make a decision that could jeopardize its accreditation status. However, the Department will review the state travel policy and the NAIC handbook in developing the formal policy for insurance company examinations. The Department with its informal policy had instituted the submission of receipts in this policy. We will include the submission of receipts into our formal policy to be developed at the Department.

LACK OF SUBSIDIARY LEDGERS & VERIFICATION OF CLAIMS – MINE  
SUBSIDENCE FUND

Recognizing the need for an assessment of the sufficiency of the assets of the mine subsidence fund and need to further verify risk, exposure, and current claims compliance a contract was subject to bid and awarded to Pinnacle in 2006. Initial steps have been to collect the data regularly provided to the Department by the companies. Pinnacle has been tasked with developing surveys the Department identifies as examination call letters to obtain and then independently verify specific claims, premium, and reporting information from the 700 plus companies that write this coverage for residents in southwest Indiana.

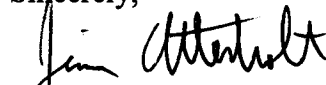
The Department has confidence that the results of his assignment and inquiries to the insurance companies will be beneficial in many ways. First, he will be able to verify premium collection to production of policies; second, he will be able to review and verify any and all claims made and paid; third, he will be able to identify what information will be further necessary for us to identify whether the current rate structure is consistent with the risk of loss; and finally, the firm should be in a position to recommend whether this state managed reinsurance might someday be a candidate for privatization or a return to the marketplace.

BAIL AND RECOVERY AGENT EXAMINATION FEES –

Due to multiple difficulties with the vendor a new contract was bid and awarded effective 01/01/2007. The bail agent examinations became publicly available on February 2, 2007. The \$100.00 fee currently being charged is consistent with the statute.

The responses contained herein represent a compilation of responses contributed by the deputies and managers responsible for the subject area of the comment. All responses are true and complete evaluations of the problems noted in the auditor's comments.

Sincerely,



Jim Atterholt  
Commissioner  
Indiana Department of Insurance